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## National Energy Board

# *The Board's approach on the regulation of tolls and tariffs under Part IV of the NEB Act*



*This information bulletin provides the text of an outline formulated by the National Energy Board concerning its approach to the regulation of pipeline tolls and tariffs under Part IV of the National Energy Board Act*

## Information Bulletin 6

March 1984



## **THE BOARD**

The National Energy Board is an independent federal agency that was created by the Parliament of Canada in 1959. The Board's prime function is to regulate certain areas of the oil, natural gas, and electrical utility industries. Its powers and jurisdiction are based on the National Energy Board Act. Copies of the Act are available from the Canadian Government Publishing Centre, Supply and Services Canada, Ottawa, K1A 0S9 (Price: Canada \$2.75; other countries \$3.30, prices subject to change).

## **PUBLICATIONS**

This information bulletin is one of a series that the Board is publishing on its activities and procedures. Comments on this bulletin or suggestions for future topics would be most welcome.

These bulletins provide general information only. For exact details on particular items, see the relevant legislation.

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Cat No. NE12-3/6E  
ISSN 0825-0170

**This Information Bulletin is published separately  
in both official languages.**

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No. du cat. NE12-3/6F  
ISSN 0825-0189

**Ce Bulletin d'information est publié séparément  
dans les deux langues officielles.**

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# The Board's Approach on the Regulation of Tolls and Tariffs Under Part IV of the NEB Act

## Background

An important function of the National Energy Board is the regulation of the tolls and tariffs charged by pipeline companies for the transportation of oil and gas interprovincially, internationally, and from offshore areas. Under Part IV of the National Energy Board Act, the Board has the responsibility of ensuring that tolls charged by pipeline companies under its jurisdiction are just and reasonable, and that there is no unjust discrimination in the tolls charged or services provided.

Recognizing the complexities of the toll-regulating process, the Board felt that it would be desirable to provide a description of its philosophy

and approach with respect to the regulation of tolls and tariffs under Part IV of the National Energy Board Act. In preparing a paper on this subject, the Board provided an opportunity for comment by the oil and gas pipeline industry and by other parties who had shown their interest in the subject through intervention in the Board's tolls hearings during the past two years.

The process of writing and consultation has produced the outline which follows. This document is a supplementary source of information concerning Part IV matters; it should not be considered as, in any way, replacing or superseding the provisions of existing legislative instruments.

## National Energy Board Regulation of Tolls and Tariffs Under Part IV of the NEB Act

### A. Introduction

This outline is intended for information and guidance and to provide insight to pipeline companies, to interested parties in tolls and tariffs proceedings, and to the public, on the regulation of tolls and tariffs under Part IV of the NEB Act.

### B. Reason for the Regulation of Tolls and Tariffs

The transportation of oil and gas by pipeline forms part of the regulated activities in all market economies.

It is by definition a public service, is considered essential, is of interest to a large part of the population and is provided under conditions which have monopolistic attributes. The objective of regulating these activities is, therefore, to ensure that they are provided on a continuing basis, without unjust discrimination and in a cost-efficient manner approaching the costs that would prevail in a competitive market, recognizing that other factors such as government policies and competition from other energy forms may impact on regulation.

### C. Criteria Under Part IV of the NEB Act

The Board is charged with ensuring that all tolls are just and reasonable (Section 52). This requires a balancing of the interests of the

consumers, producers and shippers on the system with the interests of investors in the pipeline. (A fuller discussion of this subject is found in the Board's Reasons for Decision — TransCanada PipeLines Limited — December 1971, pages 6-1 to 6-8.)

A company must not discriminate unjustly in its tolls or tariffs or in the provision of service or facilities. (Sections 52 and 55).

The Board has the power to disallow or suspend any tariffs that do not meet these criteria. (Sections 53 and 54).

Oil pipeline companies are required to operate as common carriers (Section 59(1)), that is, such a company must provide a service to others by transporting oil owned by them through its pipeline.

The Board has the power to require gas pipeline companies to accept gas for carriage under terms and conditions specified by the Board. (Section 59(2)).

The Board also has the power to require pipeline companies to provide suitable facilities for the transportation or storage of oil and gas. (Section 59(3)).

The Board may require a gas pipeline company to extend or improve its transmission facilities if the Board finds it in the public interest to do so. (Section 60).



#### **D. Obligations of and Restraints on Pipeline Companies**

Pipeline regulation gives rise to obligations and restraints. An aim of pipeline toll regulation is said to be to simulate competition, but pipelines are not directly subject to the discipline of the marketplace; therefore, the Board believes that there is an implied obligation on the pipeline companies to demonstrate to the Board and interested parties in toll hearings that they are conducting their business as if they were subject to the discipline of the marketplace.

There are restraints on pipeline companies with respect to their regulated business because they have certain attributes of monopolies. For example, earnings are limited to a rate of return commensurate with risks, capital expenditures are essentially limited by the Board to the acquisition of assets expected to be used and useful in pipeline service, and the cost of service is limited to the level consistent with the provision of adequate service.

#### **E. Amplification of the Above Matters**

1. Hydrocarbon pipelines are vital links between supply and markets.
2. The long-term cost of service of pipelines must be kept at a level consistent with providing users with a safe, reliable and efficient service at the lowest possible cost and providing investors with a return commensurate with risk.
3. Pipelines have certain attributes of monopolies. Federally regulated pipelines, before they are constructed and operated, require a Board Certificate of Public Convenience and Necessity issued following a public hearing.
4. Pipelines must be built in an effective and efficient way and costs must be kept under tight control. Costs of approved capital projects, including overruns, are examined before being authorized for inclusion in rate base.
5. Pipeline companies, when applying for Certificates of Public Convenience and Necessity and Orders under Sections 44 and 49,

should indicate the effect of the proposed capital expenditures on the cost of service and, where the Board deems appropriate, the effect on tolls being charged.

6. The approach to pipeline toll regulation is determined according to the size and nature of their business. For example, gas pipelines require a somewhat different approach from oil pipelines because of business differences. Large pipeline systems must supply more information than small ones because the economic impact is larger. Therefore, the Board varies its approach with respect to information required from companies operating:

- (i) large gas pipeline systems,
- (ii) large oil pipeline systems,
- (iii) other pipeline facilities.

The policy of the Board is to avoid undue regulation.

7. Consistency of reporting, needed to provide insight into the financial affairs of pipeline companies, is obtained through standard codes of accounts.
8. If tolls are too low, pipeline companies generally apply for increases, but if tolls are too high, there is little incentive for the companies to apply for reductions in tolls. Therefore, the Board and interested parties need sufficient information on the financial affairs of a pipeline company to gain insight into whether tolls need adjustment.
9. For large gas and oil pipeline systems, in decisions following public hearings (except for the variable cost of service companies), the Board generally authorizes a cost of service showing the value authorized for each item of the cost of service. The Board requires that the company allocate the cost of service by quarter for each item. The Board then requires the pipeline company to provide information on quarterly actual results compared with those authorized and to explain any significant variations. This is to enable the Board to determine whether changes in tolls are likely to be needed and to test the reliability of estimates used in the hearing process.



For companies on a variable cost of service, comparisons of actual versus budgeted operating and maintenance costs are required.

For smaller pipelines, simpler information is required, generally related to return on equity and compliance with government restraint guidelines.

The precise forms of information required for monitoring purposes for each pipeline are subject to discussion between the Board and the company.

10. The Board has, in general, adopted cost-based tolls affording companies the opportunity to earn revenue up to authorized levels. Because of this and because the companies have certain monopolistic attributes, there is an onus on pipeline companies to demonstrate that their costs are reasonable and that they are being operated efficiently and effectively.
11. The Board applies the criteria of justness and reasonableness of tolls as the main yardstick in toll cases. The criteria apply to the toll as a whole.

12. The Board expects pipeline companies to act responsibly in regard to government policies such as restraint guidelines for prices and costs, to the extent that these do not conflict with the basic criteria of the NEB Act.

13. The Board expects to continue to render consistent decisions in toll cases, subject to the principle that each case must be decided on its merits, and in the light of economic and other circumstances prevailing at the time.

14. The Board attempts to respond to requests from sponsors for indications, in certificates and related toll proceedings, of the possible future course of tolls and tariffs regulation, especially if such indications are judged necessary to assist a project sponsor in deciding whether or not to proceed with a project.

